Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)))))	**CC Docket No. 00-256**
	)	

WORLDCOM COMMENTS

WorldCom, Inc. (WorldCom) hereby submits its comments on the Further Notice of Proposed Rulemaking (Notice) in the above-captioned docket.

As a general matter, rate of return regulation provides few incentives for telephone companies to operate efficiently. The incentives for efficient operation are particularly attenuated because the Commission scrutinizes rate of return carriers' costs only to a limited extent. Most of today's rate of return LECs are smaller carriers that are not required to report detailed cost information through ARMIS. And, because most rate of return carriers participate in the NECA pool, individual carriers' costs are not scrutinized by the Commission in the tariff review process, in contrast to the detailed review that the Commission applied to the larger ILECs' annual access filings in the 1980s.

Rate of return carriers' limited incentive to operate efficiently not only inflates interstate and intrastate rates, but inflates the universal service fund as well. While non-rural price cap LECs' universal service receipts are either capped, in the case of the Interstate Access Support mechanism, or determined using the Commission's Synthesis model, both of the "high cost" mechanisms available to rural rate of return carriers determine universal service support using book costs that reflect the rate base and expense "padding" that occur under rate of return regulation.

To correct these deficiencies in the current regulatory system, the Commission should adopt an incentive regulation plan and make that plan mandatory for all ILECs controlled by non-price cap ILEC holding companies with more than 200,000 access lines. Exempting smaller carriers from the incentive regulation plan would address these carriers' concerns that "lumpy" investment patterns or other characteristics of their operations are unsuited for incentive regulation, while still ensuring that the majority of access lines currently under rate of return regulation are shifted to an efficiency-enhancing form of regulation.

There is clear evidence that ILEC holding companies with more than 200,000 lines can operate successfully under an incentive regulation scheme, even when those lines are spread across several study areas or the study areas qualify as "rural." Both Valor, which controls approximately 550,000 access lines spread across four states,[1] and Iowa Telecom, which controls 285,000 access lines,[2] voluntarily elected price cap regulation in 2000. And Citizens, which operates many rural study areas, has operated successfully under price cap regulation for several years. These companies' experience shows that larger holding companies such as CenturyTel, which controls 1.8 million access lines,[3] ALLTEL, which controls 2.6 million access lines,[4] and TDS, which controls 600,000 access lines,[5] could achieve increased productivity and operate successfully under an incentive regulation scheme.

Rather than create a completely new incentive regulation scheme based on "revenue per line," the Commission should, to the extent possible, adapt the existing price cap system. Specifically, the ILECs' rate elements should be grouped into common line, traffic sensitive, special access and trunking baskets in the same manner as under the existing price cap system.

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[1] Valor Comments, CC Docket No. 96-45, February 4, 2002.
[2] Iowa Telecom Comments, CC Docket No. 96-98, May 9, 2001.
[3] CenturyTel Form 3Q2001 Form 10-Q
[4] ALLTEL 3Q2001 Form 10-Q.

Prices in each basket, as computed by the Actual Price Index (API), would be capped by the Price Cap Index (PCI), which would be adjusted annually by the application of an X-factor and GDP-PI as under the existing price cap system. Most of the other features of the existing price cap plan could be incorporated as well, including the cost support requirements for above-cap filings, the rules governing rate restructures, and the rules governing exogenous changes. Significant deviations from the existing price cap plan would be necessary only to the extent necessary to accommodate differences in common line rate structure.

Initially, the X-factor for the new incentive regulation scheme should be set equal to GDP-PI plus a consumer productivity dividend of 0.5 percent. The fact that Citizens, Valor, and Iowa Telecom operate successfully under a price cap system with an X-factor equal to GDP-PI[6] demonstrates that the productivity growth reflected in an X-factor equal to GDP-PI is achievable by larger holding companies, even those that operate predominantly in rural areas. Indeed, Citizens, Valor, and Iowa Telecom operated successfully under much higher X-factors of 5.3 percent or 6.5 percent, in addition to the one-time July, 2000 rate reductions required by the CALLS Order. The additional 0.5 percent consumer productivity dividend is necessary to ensure that LECs flow-through a reasonable portion of the benefits of productivity growth to ratepayers.

Because the Commission cannot be certain that the X-factor set in this manner is accurate for current rate of return LECs generally or for individual LECs, the Commission should adopt a "backstop" sharing mechanism modeled on the sharing plan adopted in the LEC Price Cap Order to ensure that "consumers receive their fair share of the productivity gains that will occur, just as they would in an industry with keener competition."[7] Specifically, the Commission should

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[5] TDS 3Q2001 Form 10-Q.

[6] Under the CALLS rules, the X-factor equals GDP-PI once the "target rate" has been achieved (but equals 6.5 percent for the special access basket until 2004). 47 C.F.R. § 61.45(b).

[7] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6801 (1990) (LEC Price Cap Order).

require incumbent LECs to share 50 percent of any earnings between 12.25 percent and 16.25 percent, and 100 percent of any earnings above 16.25 percent.[8]

The adoption of incentive regulation will, by itself, provide significant additional pricing flexibility for incumbent LECs. To the extent that the Commission grants additional pricing flexibility, that pricing flexibility should be limited to providing carriers under incentive regulation with the authority to offer term and volume discounts for transport and special access services, and to deaverage rates into three zones, subject to SBI upper limits that limit the rate of deaveraging. Because there is no evidence of significant competitive activity in the territories served by today's rate of return carriers, the Commission should not provide such carriers with contract tariff authority. The premature grant of contract tariff authority would only allow the incumbent LECs to erect a barrier to competitive entry.

The Commission should retain the all-or-nothing rule. Contrary to ILEC claims, cost allocation rules or other accounting safeguards would not prevent carriers from shifting costs to their rate of return affiliates. As WorldCom has previously explained, rate of return carriers are, in general, subject to relaxed oversight of their accounting practices.[9] And there have been no market structure changes that would deter such cost-shifting; because rate of return carriers face little or no competition, market forces would not constrain the rate increases that would result from cost-shifting.

Puerto Rico Telephone Company (PRTC) should be required to convert to price cap regulation. One of the new rules adopted in the <u>CALLS Order</u>, Section 54.801(c), specifically provides that if a price cap LEC acquires exchanges from a rate of return LEC, those exchanges become eligible for Internet Access Support "beginning with the next support recalculation."[10] Moreover, in determining that the $650 million fund size was "sufficient," the Commission

[8] <u>Id</u>.
[9] Notice at ¶ 270 n.624.
[10] 47 C.F.R. § 801(c).

placed great weight on the "negotiated nature of the $650 million estimate."[11] In light of its reliance on the negotiated nature of the fund size, the Commission must presume that the potential for PRTC to draw from the fund – and the resulting distribution of support among participating ILECs – is reflected in the $650 million cap. All parties to the CALLS negotiations were aware that GTE had acquired PRTC and were aware that the all-or-nothing rule required PRTC to convert to price cap regulation.

Respectfully submitted,
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[11] CALLS Order at ¶ 202.

CERTIFICATE OF SERVICE

I, Barbara Nowlin, do hereby certify that copies of the foregoing Comments were sent via first class mail, postage paid to the following on this 14th of February, 2002.

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